

**The Honorable Douglas L. “Doug” Flory  
Talking Points for Panel on  
The Changing Landscape of Farm Credit  
2005 Learning Conference  
Orlando, Florida  
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1. “The Changing Landscape of Farm Credit” is a very timely topic.
  - The Farm Credit System is at a crossroads, which is a major reason behind the System’s very important and extensive Horizons Project.
  - A recent USDA report, “The 20<sup>th</sup> Century Transformation of U.S. Agriculture and Farm Policy,” noted the structure of farms, farm households, and the rural communities in which they exist has evolved greatly over the last century. The report also noted that there is often debate over U.S. farm programs because current policies were tailored for a time in American agriculture that no longer exists.
  - This issue also applies to the Farm Credit System, because the Farm Credit Act of 1971 was written for an American agriculture that is totally different today. Not only is agriculture different, but the entire financial industry is vastly different today than when the Act was written.
  - To remain viable and relevant, the Farm Credit System will need to adapt to address the changing face of agriculture and rural America.
2. Rural Landscape is Changing
  - Rural and farm communities are becoming more interdependent. Farming no longer anchors most rural communities and economies as it did through the mid-20<sup>th</sup> century. Job growth in agricultural areas is now more likely to come from rural industries related to farming than from farming itself. I believe this means that for the Farm Credit System to successfully compete in the 21<sup>st</sup> century, it must evolve and adapt to this shift in focus to rural America.
3. Key Risks Facing U.S. Agriculture
  - The Agency’s Risk Analysis Division recently developed a report on the “Key Risks Facing U.S. Agriculture.” I want to mention some of the longer-term concerns noted in the report.
  - Administration’s priorities – Federal budget deficit putting farm program payments at risk.
  - World Trade Organization (WTO) decisions could lead to major program revisions.
  - U.S. losing its competitiveness in agricultural markets to developing countries.
  - Water shortages and quality issues pose risk to future farming in the West and Great Plains.
  - Changing consumer preferences, safety concerns indicate shifts in demand and cost.

- Aging farm operators and changing rural demographics alter the System's market.
- Legislative initiatives could affect the System and/or the Agency (GSE status).

#### 4. The Changing Landscape of FCA

- We have an "almost" new Board Chairman (Nancy Pellett was appointed Chairman just over a year ago). We basically have a new FCA Board – Dallas Tonsager was appointed to replace Mike Reyna last December. So all three Members have been on the Board less than 3 years.
- The Agency recently conducted a strategic study, which has resulted in a new organizational structure.
- With a new FCA Board in place, we took a look at our examination and regulatory philosophies and adopted new philosophies, with a focus on how we need to carry out our examination and regulatory role in going forward in a new era. (The FCA philosophy statements are available on FCA's Web site under the Legal Info section. Select FCA Handbook, then FCA Board Policy Statements, then FCA-PS-53, Examination Philosophy or FCA-PS-59, Regulatory Philosophy.)

#### 5. Chairman's Key Goals (which Board Member Tonsager and I totally support)

- Improve communications, both internally and externally, but especially with the System.
- Ensure the Agency is run in an efficient and effective manner.
- Be a strong advocate for agriculture and rural communities. Nancy has especially emphasized the opportunities the System can pursue by using its investment authorities to assist, rebuild and revitalize Rural America. This was addressed in our Information Memorandum last January, which also invited System institutions to submit proposals for pilot programs. Since January, we have approved five new pilot programs and mission-related investment transactions proposed by System institutions that support the mission of the Farm Credit System and improve the flow of funds to rural areas. In addition, there are two additional proposals that have been submitted and are currently being reviewed by Agency staff.

#### 6. FCA Strategic Study

- Last fall we initiated a series of studies to look at our examination process and to review our regulation and policy development process. We also conducted a thorough review of our internal support functions. The intention was to refocus our efforts in light of changed conditions and to develop processes that better respond to the new environment we operate in and to the customers we serve.
- The goal of our strategic study was to determine the structure, skills, and human capital needs of the Agency for the next 5-7 years.
- As a result, the FCA Board recently approved a new organizational structure and some key personnel changes that will position the Agency to better fulfill its role in the future.

7. New Regulatory Philosophy – Give High Priority to:

- Issues that enable the System to more effectively accomplish its mission.
- Issues that pose significant risks to the successful operation of the System.
- Providing the System with flexibility consistent with changes in the law, agriculture and rural America.
- Ensuring an adequate and flexible flow of money into rural areas.

8. Strategies to Accomplish Regulatory Philosophy

- We will develop regulations based on a reasoned determination that benefits of any proposed regulation justify its cost.
- We will focus our regulatory efforts on issues that address identified risks in System institutions or enhance the ability of System institutions to better meet the needs of agriculture and rural America.
- We will use diverse approaches to encourage public participation in the development and review of regulatory proposals in appropriate circumstances.
- We will emphasize the cooperative principles of a farmer-owned Government-sponsored enterprise by advancing regulatory proposals that encourage farmer- and rancher-borrowers to participate in the management, control, and ownership of their institutions.
- We will work to eliminate unnecessary regulations that impair the ability of the System to accomplish its mission to serve agriculture and rural America and any regulations that are unduly burdensome, costly, or not based on the law.

9. New Examination Philosophy

- Encourage even greater use of risk-based principles by OE.
- Our examiners will take on more of an oversight approach to evaluating how System institutions identify and proactively manage risks – especially emerging and systemic risk to agriculture and the System.
- The amount of examination resources devoted to a System institution and the scope of an examination will depend on an institution's ability to identify and manage its risks.
- Oversight and examination efforts will be heightened and accompanied by appropriate preventive, corrective, or enforcement actions when institutions are unable or unwilling to address material unsafe and unsound practices or comply with law and regulations.
- This risk-based approach must promote effective communications with System institutions. Examiners are an essential communication link with the System through ongoing institution oversight, on-site examinations, meetings with boards and management, and written reports and correspondence.
- We will maintain adequately trained examiners who understand the unique risks and opportunities of agriculture as primarily a biological industry.
- We will also maintain an appropriate level of regulatory and financial industry experience and skills.

- And finally, we will communicate and work effectively with System institutions to ensure they remain safe and sound and able to fulfill their public purpose.

#### 10. Three Key Issues for the Future

- Preserving the Farm Credit GSE.
- Cooperative Principles.
- Diversity.

#### 11. Benefits of GSE Status

- I recently spoke with Jamie Stewart, President and CEO of the Federal Farm Credit Banks Funding Corporation, about the need to better educate the System about the value of its GSE status. He agreed and followed up by listing several benefits of GSE status.
- Lower cost of funding – about 80 basis points from lower cost of borrowing and lower tax rate. This benefit is worth about \$800 million a year.
- Continual access to capital markets. This allows maximum flexibility to match fund assets, and a wider diversity of eligible investors.
- Ability to attract Central Bank investors. Big buyers are willing to give the System exceptional pricing.
- Exemption from SEC registration.

#### 12. Cooperative Roots

- As the Farm Credit System moves into the 21<sup>st</sup> century and continues to evolve in serving a changing rural America, I think it needs to take special care to remember its “cooperative roots.”
- In 1916 Congress established the FCS as a group of cooperatively organized financial institutions because it believed this organizational form – with farmer ownership and control – was the best way to provide a permanent and affordable source of credit to agriculture and rural America.
- The FCS of America case demonstrated how rapidly borrowers can rise to the occasion in exercising their influence. As a result of this event, cooperative principles are now an important topic of conversation throughout the System.
- The cooperative nature of the Farm Credit System has been one of the keys to its success for nearly 90 years. Not only has the cooperative structure served the System well from a business standpoint, it has helped generate much of the support and defense of the System throughout its history in serving the credit needs of farmers, ranchers, cooperatives, and rural America.
- I believe the cooperative principles of the System will likely continue to be key to its future success – both in its business operations and its pursuit of legislative changes.

### 13. Need to Strive for Diversity

- As I have been meeting with System institutions since I came on the Board 3 years ago, one of my key discussion issues is diversity. Diversity includes demographics, both geographic and commodity representation. But in addition, striving for diversity should include considering different experiences, skill sets, and viewpoints.
- Diversity also includes considering women and minorities, not just for boards, but also for nominating committees, management and employees. There is a need for good, open dialogue in the System on how to improve diversity. I believe Farm Credit Boards should keep this issue in mind as they seek independent outside directors. I would also encourage them to address diversity as part of their strategic planning efforts.

### 14. Conclusion

- The changing landscape of farm credit, as well as all of agriculture and rural America, present many challenges ahead for the Farm Credit System. But there are also many opportunities. I encourage the System to embrace these challenges by working together and with others in carrying out its mission as the oldest GSE to serve agriculture and rural America.